

# EXECUTIVE SUMMARY

## FORWARD-LOOKING MACROECONOMIC POLICIES FOR INCLUSIVE AND SUSTAINABLE DEVELOPMENT

Economic growth in the developing countries of Asia and the Pacific slowed to 5.6% in 2012 as a result of the double-dip recession in the euro zone and the tepid recovery of the U.S. economy. Although growth is projected to inch up to 6% in 2013, this rate is still below the average of 7.8% achieved in 2010-2011 and the average of 8.6% observed during the pre-crisis period of 2002-2007. More importantly, the extent to which the region's economic growth is contributing to the achievement of key development goals remains unclear.

Despite a significant reduction in poverty, the region is still home to more than 800 million poor struggling to survive on an income of less than \$1.25-a-day. This figure represents nearly two-thirds of the world's poor. Notably, in many countries in the region, including the most populous ones, rapid growth in income since the 1990s has been accompanied by increases in income inequality. In addition, the high resource-intensity of economic growth has spurred a rapid rise in emissions of greenhouse gases and made countries increasingly vulnerable to commodity price shocks, while key natural resources, such as forest covers, fisheries and fresh water, have been overexploited.

Economic insecurity has also risen amid rapid growth. More than 1 billion workers in the region are in vulnerable employment – characterized by low wages, no benefits, no job security and difficult conditions of work that undermine workers' fundamental rights. More than 900 million people in the region live just at the edge of extreme poverty on an income of between \$1.25-a-day and \$2-a-day, with the risk of a small shock or personal misfortune pushing them into extreme poverty in the absence of a comprehensive social protection floor.

Food security is also a major problem in Asia and the Pacific, with an estimated 563 million people undernourished. Economic insecurity and vulnerability are exacerbated by increasingly damaging natural disasters, which many believe are related to climate change and environmental degradation. Notably, during the period 1970-2010, the average number of people exposed to yearly flooding in Asia more than doubled from 29.5 million to 63.8 million while the population residing in cyclone-prone areas increased from 71.8 million to 120.7 million. In sum, despite the region's rapid economic growth, hundreds of millions of people continue to be highly vulnerable and insecure. Economic expansion has not been inclusive enough and has not translated into increased security of jobs and livelihoods. Instead, growth has been mostly jobless, that is without a commensurate growth of decent and productive employment in the formal sector. As a result, livelihood insecurity and disparities of opportunities and outcomes, including income, assets and wealth, are on the rise and reinforcing one another.

These trends, however, are not inevitable. The historical experience of successful economies in the Asia-Pacific region shows that rapid economic growth is not incompatible with a broad-based dissemination of opportunities for progress across the population, as elaborated in chapter 3. Enhancing the resilience of peoples' livelihoods and the inclusiveness of the development process is possible and must be a priority of the development agenda beyond 2015 for the Asia-Pacific region. This edition of the *Survey* argues that macroeconomic policies, especially fiscal policies, could and should play an instrumental role in achieving this priority.

## **Making development more inclusive and sustainable can help support growth**

Inclusive and sustainable development can contribute to supporting broad-based economic growth in the region by stimulating domestic sources of aggregate demand, which can have beneficial spillover effects across the region through trade. This edition of the *Survey* estimates that the effort of China to rebalance its economy towards a more pro-poor and consumption-led pattern of development could spur an additional \$13 billion worth of exports from other countries in the region during the period 2013-2015, representing an additional 0.5 of a percentage point to the region's rate of growth of exports.

The setting of minimum wages is another policy that can contribute to both addressing rising income disparities and supporting aggregate demand. The *Survey* argues that a minimum wage policy, if it is designed carefully and contains supportive adjustment measures, boosts workers' productivity and income and improves long-term job prospects without adversely affecting businesses. For example, it is estimated that the recent increases in minimum wage in Thailand could increase employment growth by up to 0.6 of a percentage point and real GDP growth by 0.7 of a percentage point by 2015 compared to a baseline scenario of no minimum wage increase.

In addition to demand policies, making the development process more inclusive and sustainable calls for supply-side policies to remove structural impediments to growth such as energy shortages and inadequate infrastructure. Supply-side policies aimed at reducing the carbon intensity of growth are also needed to minimize adverse impacts of economic activity on natural resources and commodity prices. The agricultural sector plays a fundamental role as a producer of food and employer of approximately 60% of the working population in the region, including the majority of the poor. After decades of neglect, the sector deserves special attention, especially in the light of challenges emanating from a growing population and an increased incidence and intensity of extreme weather events.

The implementation of both demand-side and supply-side policies towards inclusive and sustainable development relies fundamentally on the ability of States to allocate public spending – and to create a conducive environment for private investments – in key economic and social sectors of the economy. This requires broad-based forward-looking macroeconomic policies that balance stabilization and development needs.

## **The role of macroeconomic policies**

The dominant macroeconomic policy paradigm since the early 1980s has emphasized stabilization in the narrow sense of keeping inflation at a very low single-digit level and achieving a primary budget surplus or a very low deficit-to-GDP ratio. In developing countries, there often has been a trade-off between achieving such stabilization targets and broader development objectives. Many countries have achieved them at the cost of development, for example, by cutting public investment in key areas and expenditures

on education and health. Indebted countries in the euro zone are also prioritizing fiscal austerity at an enormous economic and social cost associated with high unemployment.

While keeping inflation and the fiscal accounts under control are important objectives of macroeconomic policy, disregarding important development objectives could be highly detrimental for an economy's long-term prospects. In the light of the extensive development challenges of Asia and the Pacific associated with the region's high degree of economic insecurity, large development gaps, significant infrastructure shortages and unsustainable environmental impacts, there is clearly a need to balance the stabilization and developmental roles of macroeconomic policies.

Such balance could entail changing the way fiscal and monetary policies are designed and implemented, and how issues pertaining to public debt or inflation are viewed. In particular, as argued in previous editions of the *Survey*, there has to be greater emphasis on the quality and composition of public expenditure, rather than on aggregate budget deficits and public debts. The present *Survey* further develops this theme by providing estimates of the required public investment for a set of policies to enhance the region's resilience and inclusiveness in selected countries. These policies include the provision of an employment guarantee for a limited number of days (100 days) in a year, basic social services in education and health, income security to older persons and persons with disabilities and ensuring energy for all by 2030.

These policies are examples of forward-looking macroeconomic policies because they can promote sustainable development and lead to sustained, inclusive and equitable economic growth. The importance of forward-looking macroeconomic policies has been recognized in key United Nations documents, such as the outcome document of United Nations Conference on Sustainable Development (Rio+20), which was held in Rio de Janeiro, Brazil, from 20 to 22 June 2012. It is expected that the contents of the current *Survey* will contribute to policy debates about how to realize the goal of inclusive and sustainable development in the Asia-Pacific region.

### **Prospects for 2013**

As indicated above, economic growth in the developing Asia-Pacific economies is expected to increase slightly to 6% in 2013 from 5.6% in 2012. The increase is partly due to an expected improvement in global demand arising from steady, although subpar, growth in the United States and a limited rebound in the performance of major emerging economies. The two regional giants, China and India, are expected to rebound somewhat from a slowdown in 2012. China is expected to grow by 8% in 2013, slightly up from 7.8% in 2012, while India is expected to recover from its relatively low 5% growth in 2012 to 6.4% in 2013. Somewhat improved global trade is expected to support growth in export-led economies, such as the Republic of Korea (from 2% in 2012 to 2.3% in 2013), Hong Kong, China (from 1.4% to 3.5%) and Singapore (from 1.3% to 3%).

Growth in North and Central Asia is likely to remain stable, as the subregion continues to benefit from high global energy prices and sustained growth in the Russian Federation (3.4% in 2012 and 3.6% in 2013). In South and South-West Asia, four countries in addition to India – Afghanistan, Bangladesh, Bhutan and Sri Lanka – are projected to grow by 6% or more in 2013. In contrast, most Pacific island developing economies are expected to experience slower growth in 2013. For example, the rate of growth in Papua New Guinea is expected to drop to 4% in 2013 from 9.2% in 2012 as a result of the winding down of a large liquefied natural gas construction project.

## Investing in inclusive and sustainable development

The current issue of the *Survey* estimates, as an illustrative example, the public investment needs to deliver a package of policies to promote inclusive and sustainable development in 10 Asia-Pacific countries: Bangladesh, China, Fiji, India, Indonesia, Malaysia, Philippines, Russian Federation, Thailand and Turkey. The package includes the following six elements:

- A job guarantee programme that is available to all participants in the informal sector for 100 days per year and pays benefits equivalent to the national poverty line;
- A universal, non-contributory pension for all aged 65 or older valued at the national poverty line;
- Benefits to all persons with disabilities between the ages of 15 and 65 equivalent to the national poverty line;
- Increasing the share of public health expenditures of GDP to 5% by 2030;
- Universal enrolment in primary education by 2020 and in secondary education by 2030; and
- Three energy goals to be achieved by 2030: (i) universal access to modern energy services, (ii) doubling the global rate of improvement in energy efficiency, and (iii) doubling the share of renewable energy in the global energy mix.

The overall investment requirements to implement such a policy package vary across countries, with median values of 5.8% of GDP by 2020 and 8.2% of GDP by 2030. Most of the increase between 2020 and 2030 is due to health expenses – as they are assumed to rise gradually until 2030 – and pensions – due to the increase in the share of the population aged 65 and above. In the case of China, the cost of the package is projected to reach 3.3% of GDP in 2020 and 5.2% of GDP by 2030. For other countries, such as India, Indonesia, Malaysia, the Russian Federation, Thailand, Turkey and Viet Nam, the numbers are projected to vary between 4.7% and 9.8%. While these amounts are not trivial, they are affordable. Because of the low tax revenue-to-GDP ratios prevailing in the region, measures such as broadening tax bases, making tax structures more progressive, improving the efficiency of tax administration and tightening regulations on tax havens could raise the required financing. The cost of the package is projected to exceed 10% of GDP by 2030 only in Fiji (13%) and Bangladesh (22%). This suggests that economies with special needs, such as small island developing states and least developed countries, will need significant external assistance from development partners to complement their domestic resource mobilization efforts.

In addition, a long-term macroeconomic simulation exercise shows that governments can pursue inclusive and sustainable development while maintaining fiscal sustainability and price stability at the same time. This suggests that there is not necessarily a tradeoff between economic growth, social development and environmental sustainability. The three pillars of sustainable development can support and strengthen each other, thus challenging the “grow first” paradigm.

This is very encouraging. It vindicates the importance of rethinking and adopting broad-based forward-looking macroeconomic policies for a win-win development for both people and the planet as recognized by the world leaders at the 2010 Millennium Development Goals Summit and again at the Rio+20 conference in 2012.